TAKING OWNERSHIP OF OUR ZIMBABWE'S FUTURE

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INTRODUCTION

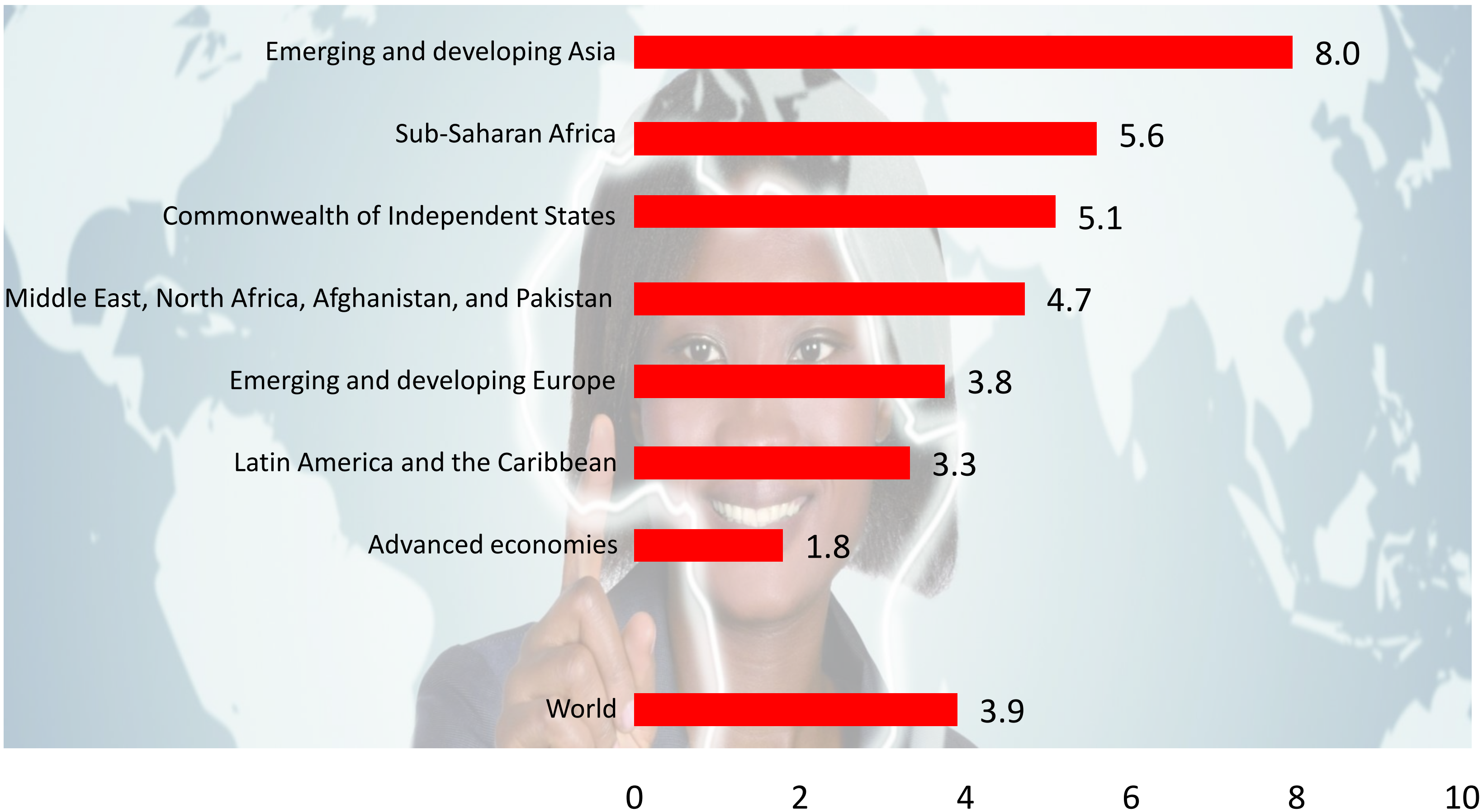
- Contrary to the debate in the media, the tired – indeed tiresome – claims of corrupt individuals responsible for economic failure and the shortermism of diplomats and international bureaucrats, there is no quick fix to Zimbabwe’s economic crisis – only a long, hard slog.

- Zimbabwe’s current economic crisis – the second worst since independence – after the hyperinflationary meltdown – is not new.
- The economy has underperformed for much of the last 50 years.

SSA economic growth outperforming most regions

Economic Growth of Major Regions, 2000-2014

Average annual GDP growth in percent

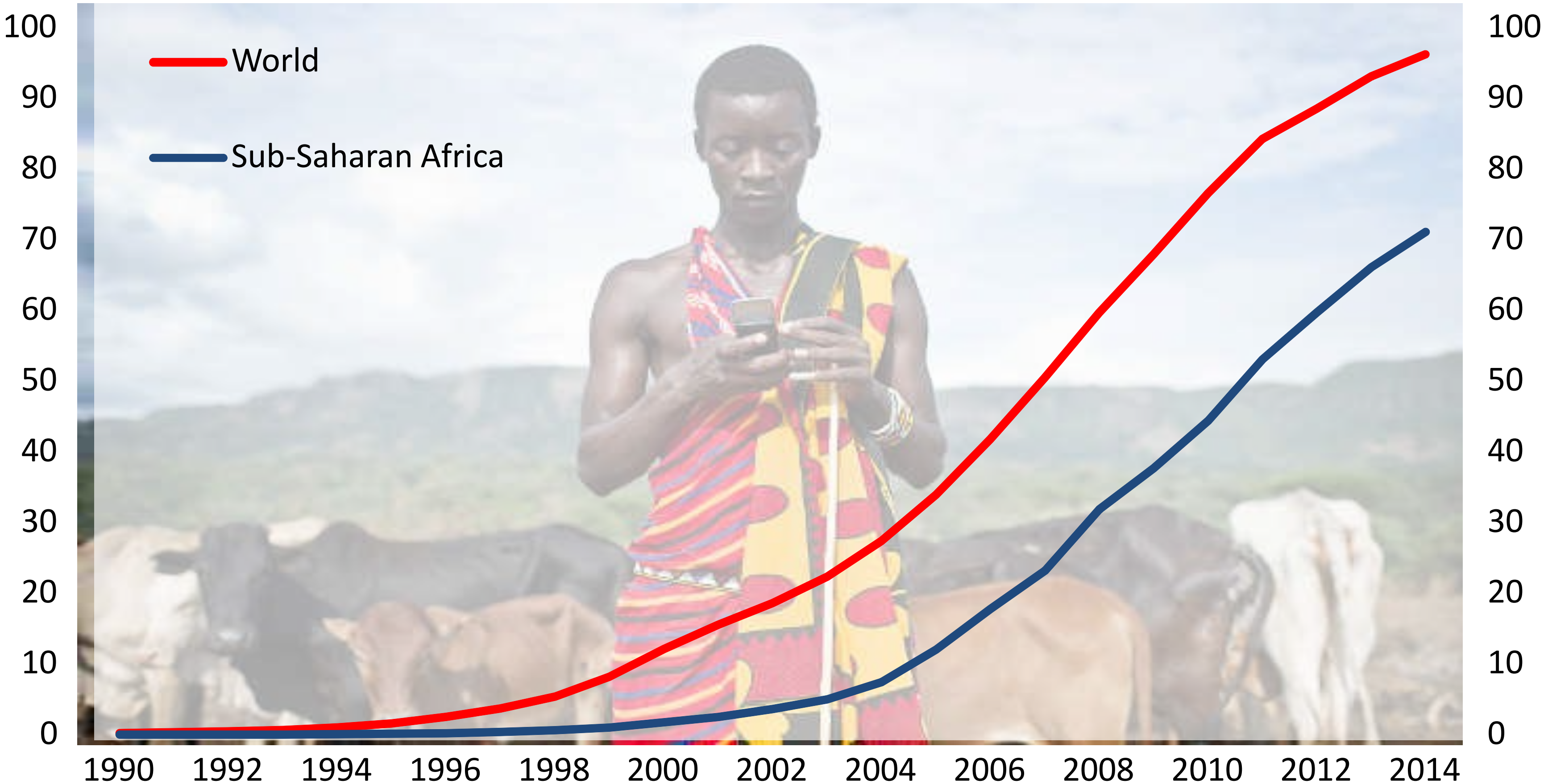


Source: IMF World Economic Outlook Database October 2015

Strong technological advances in SSA

Mobile Cellular Subscriptions, 1990-2014

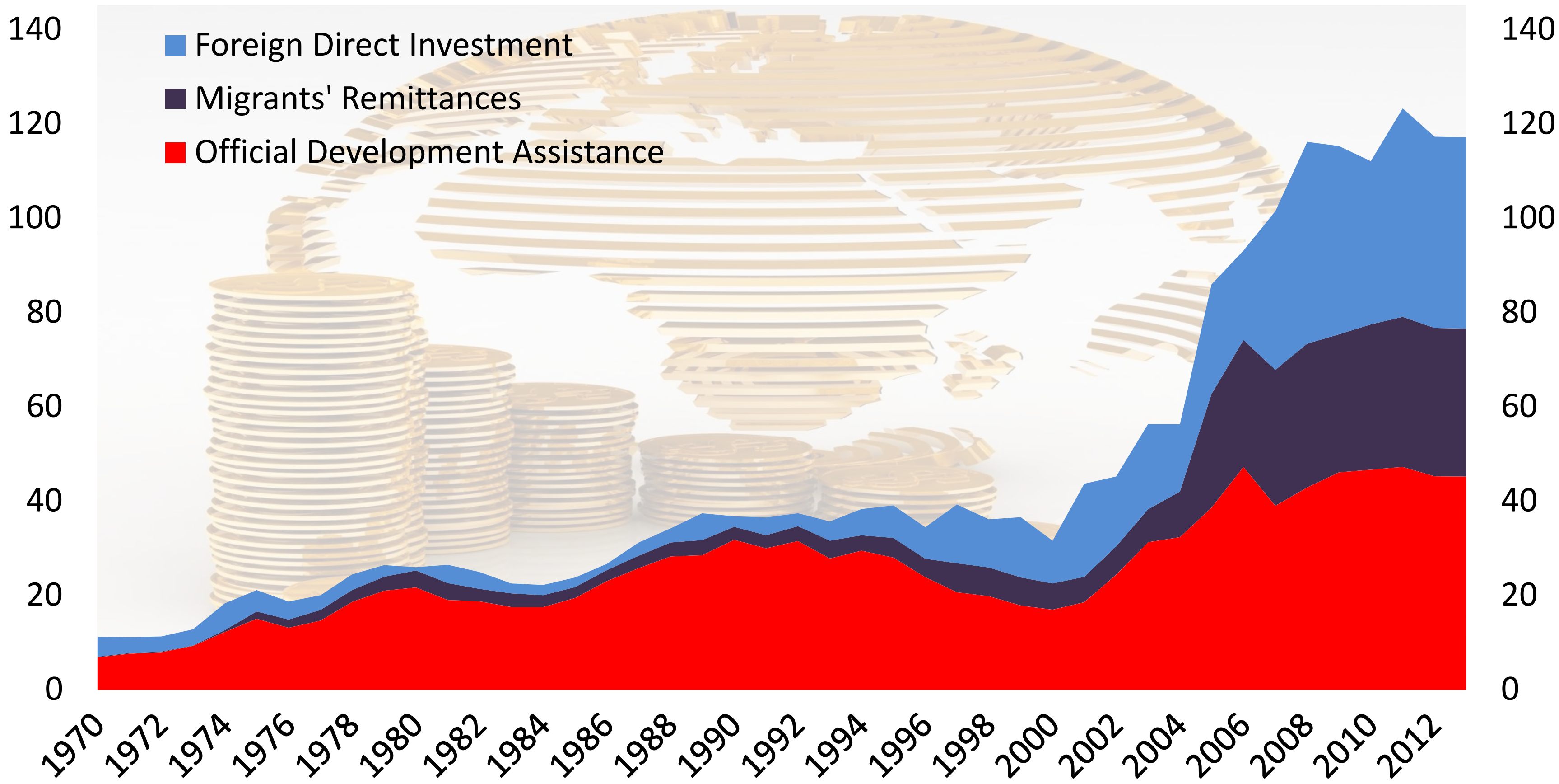
Per 100 people



Source: World Bank - World Development Indicators

FDI in SSA has grown by 400% since 2000

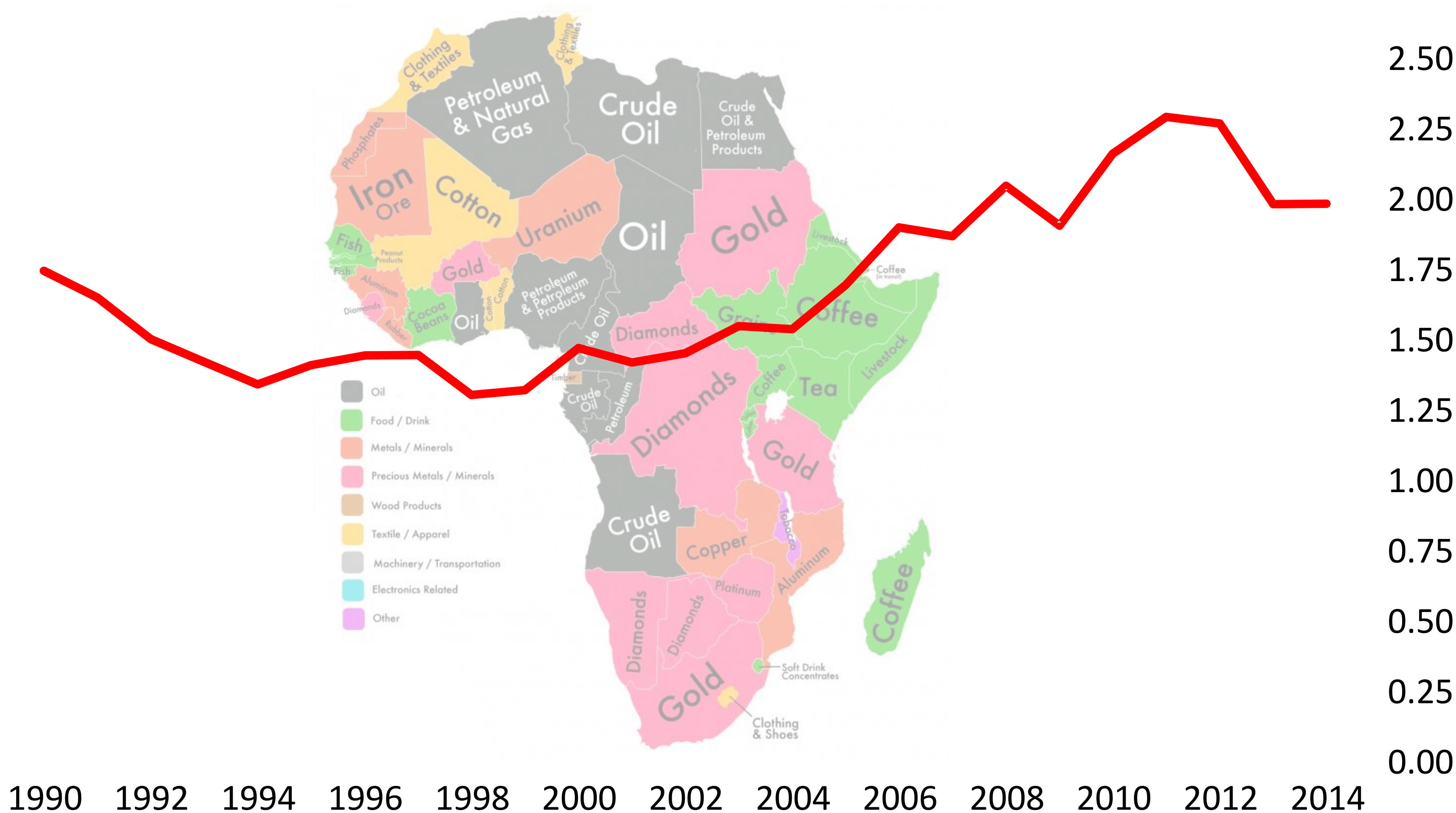
Billions of US dollars, 2013 prices, 1970 -2013



Source: World Bank, OECD, and Wallen Economics

Robust SSA export growth since 2000

Sub-Saharan African Exports as a Share of Global Exports*, 1990-2014
Percentage



*Exports of goods and services

World Development Indicators, and Wallen Economics

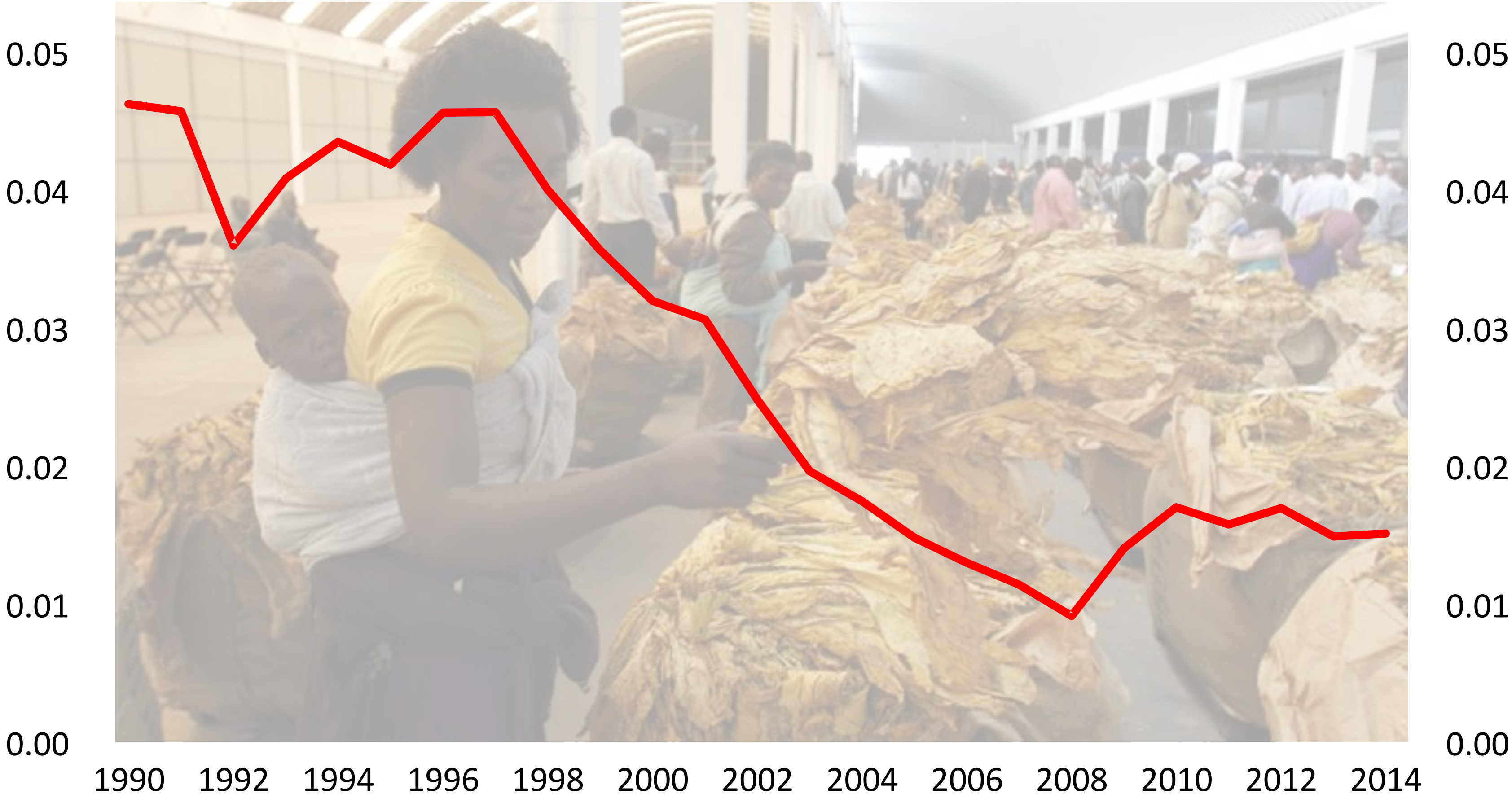
Increasing market share for Zambia since 2000

Source: World Bank - World Development Indicators, and Wallen Economics

Zimbabwe has not been following the SSA trend

Zimbabwe's Exports as a Share of Global Exports, 1990-2014

Percent

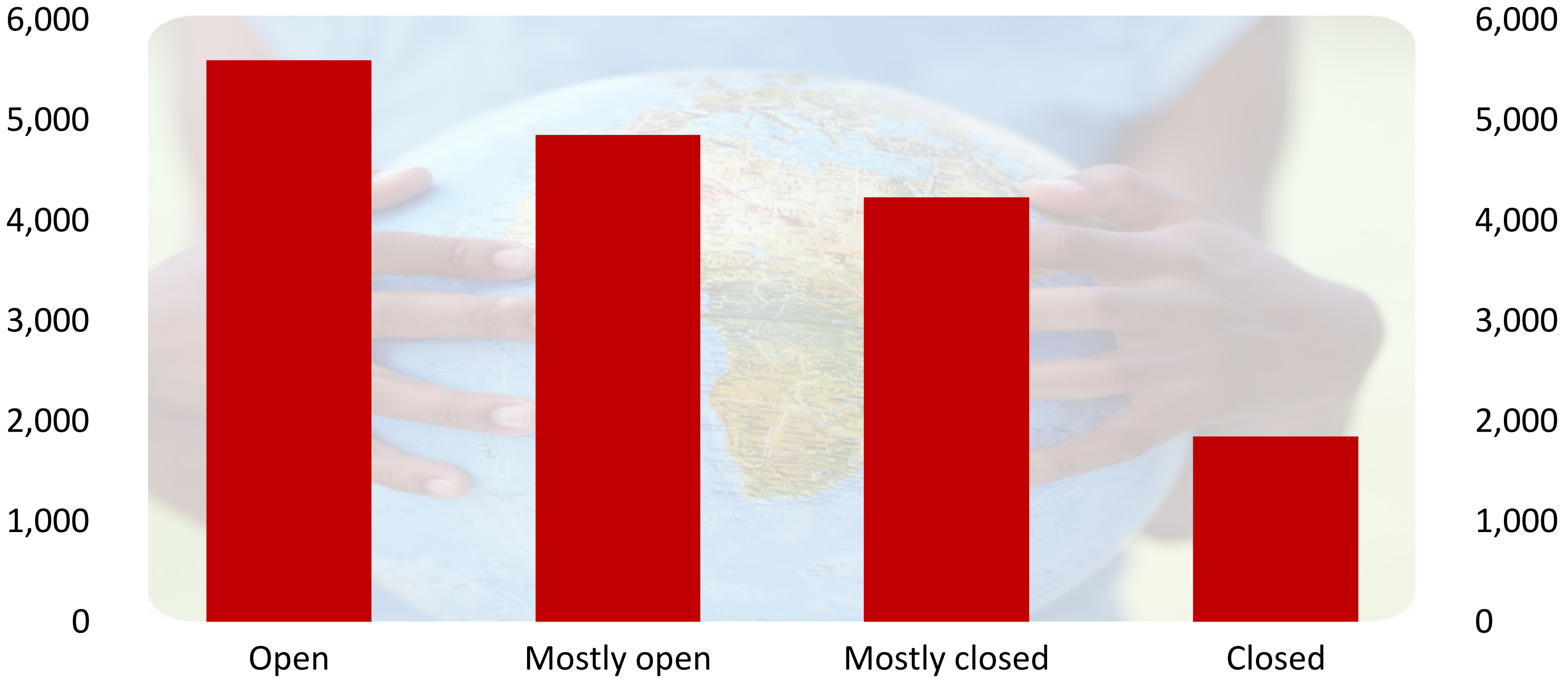


Source: World Bank - World Development Indicators, and Wallen Economics

Higher income per capita in open countries

Trade Openness and GDP per Capita, Sub -Saharan Africa, 2012*

Average GDP per capita (USD, PPP) in four country groups



*Openness is measured by the Freedom to Trade Internationally index in the Economic Freedom of the World Report. The data covers 37 Sub -Saharan African countries.

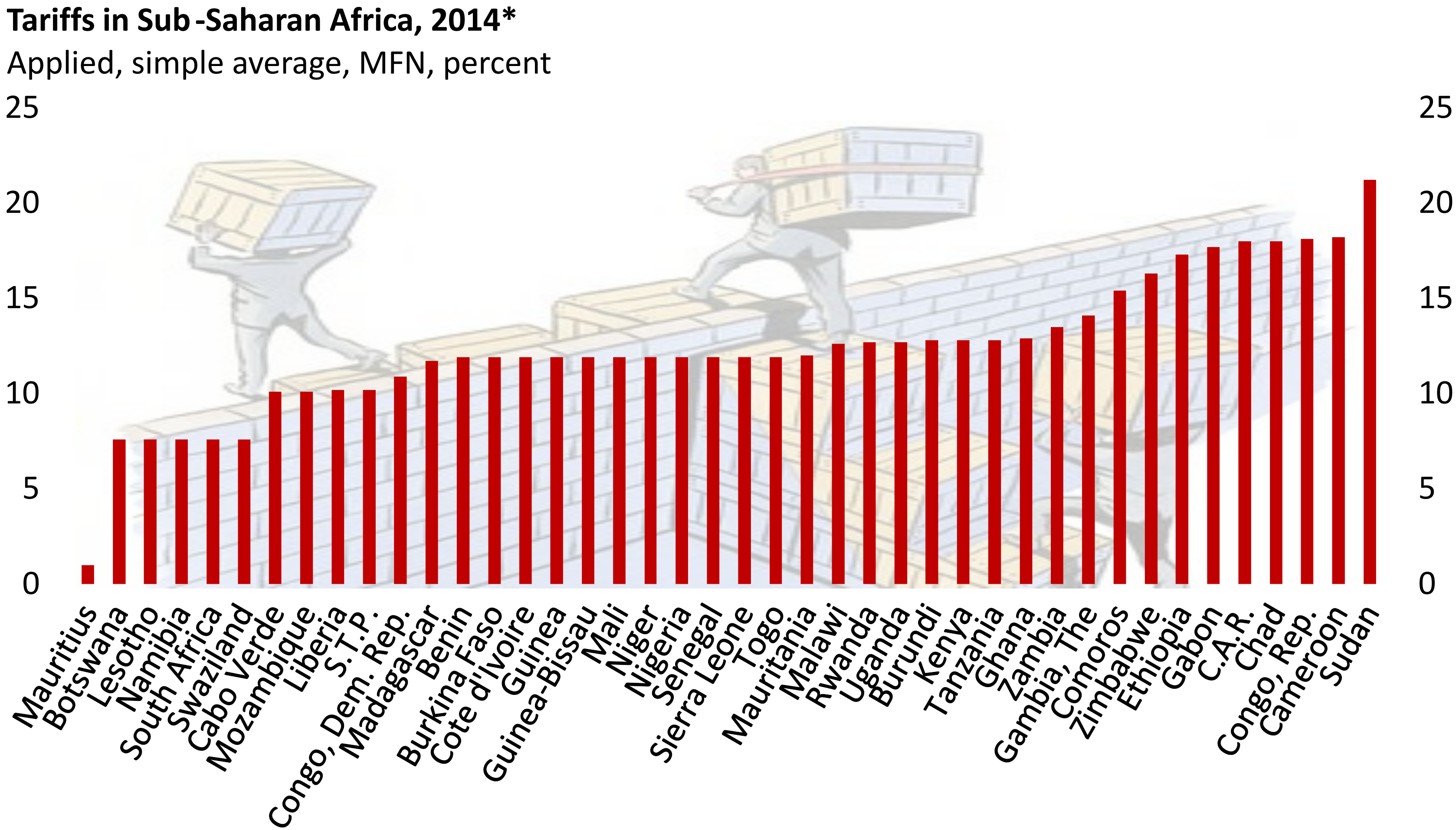
Source: Economic Freedom of the World 2014 Annual Report (Fraser Institute), IMF World Economic Outlook Database October 2014, and Wallen Economics

Research show that openness trends to affect economic growth positively

- *"Is there a link between openness and growth? Based on this survey of the more recent empirical and theoretical literature, we believe that the answer is yes. Nearly all the empirical analyses confirm this."*

Source: Andersen and Babula (2008). "The Link Between Openness and Long-Run Economic Growth". Journal of International Commerce and Economics. July.

Great difference in tariffs within SSA

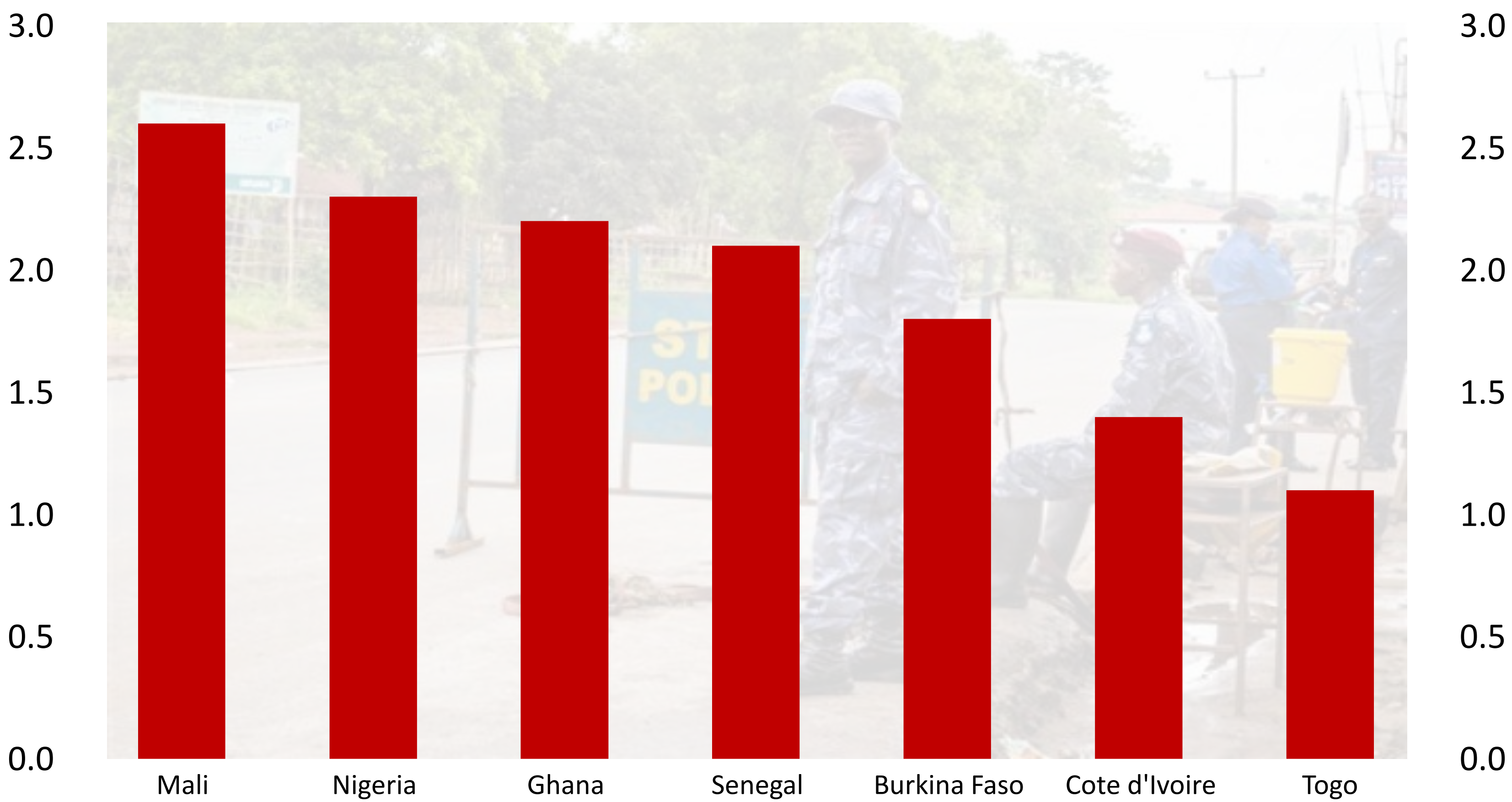


*2012 data: Guinea, Sierra Leone, Ethiopia. 2013 data: Ghana, The Gambia, C.A.R., Chad, Sudan.
Data missing: Eq. Guinea, Eritrea, Seychelles, Somalia, and South Sudan.
Source: WTO World Tariff Profiles (2014 and 2015 editions)

Roadblocks increase trading costs

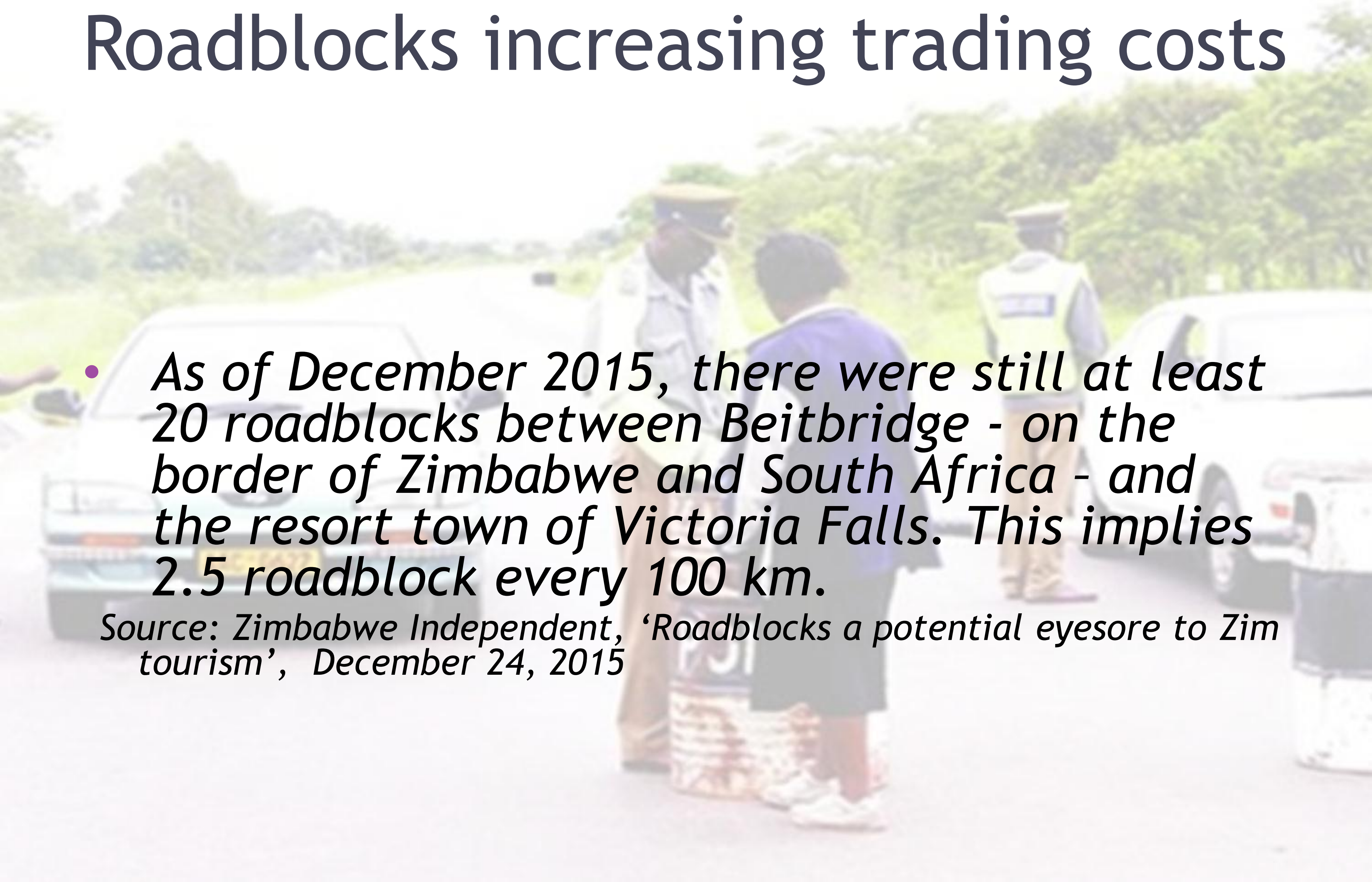
Number of Roadblocks per 100 Km

Seven West African countries. Data collected mid 2011.



Source: Coste (2014)

Roadblocks increasing trading costs



- *As of December 2015, there were still at least 20 roadblocks between Beitbridge - on the border of Zimbabwe and South Africa – and the resort town of Victoria Falls. This implies 2.5 roadblock every 100 km.*

Source: Zimbabwe Independent, 'Roadblocks a potential eyesore to Zim tourism', December 24, 2015

Serious lack of SSA intra-trade

Regional exports as a share of total exports (percent)

Source: Wallen Economics

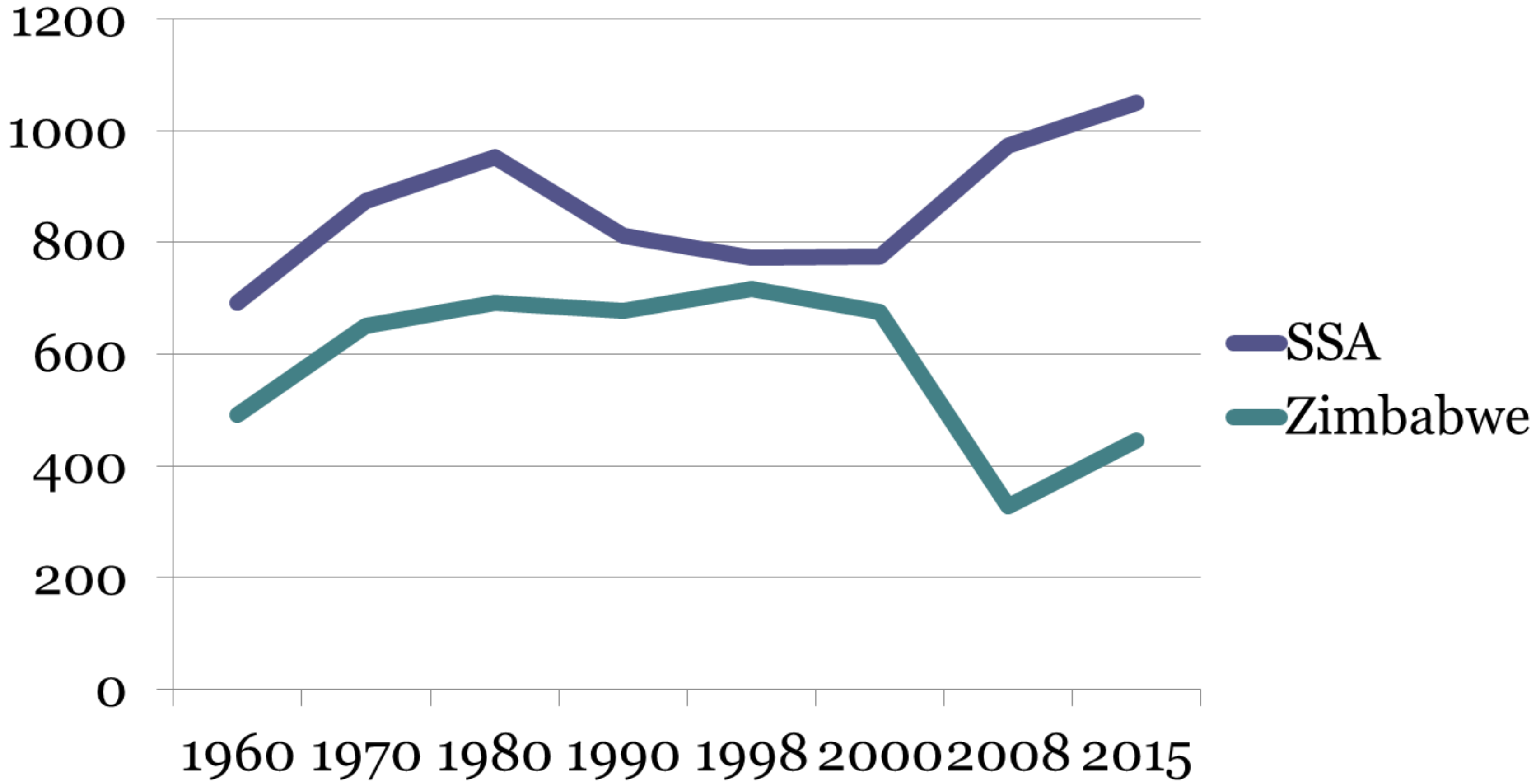
The numbers tell the story

- Income per head is no higher today than in the mid-1960s.
- We have created a mere 100 000 new formal sector jobs since 1980 during which time the population has doubled.
- Today one person in 15 has a formal sector job compared with one in 6 in 1980.

FALLING BEHIND

- In 1980, a quarter of formal employees had jobs in the public sector.
- Today, it is about half.
- Two thirds of the population (75% in rural areas) live in poverty.
- In 1960, incomes per head were 73% of the sub-Saharan average.
- Today that figure is close to 40%

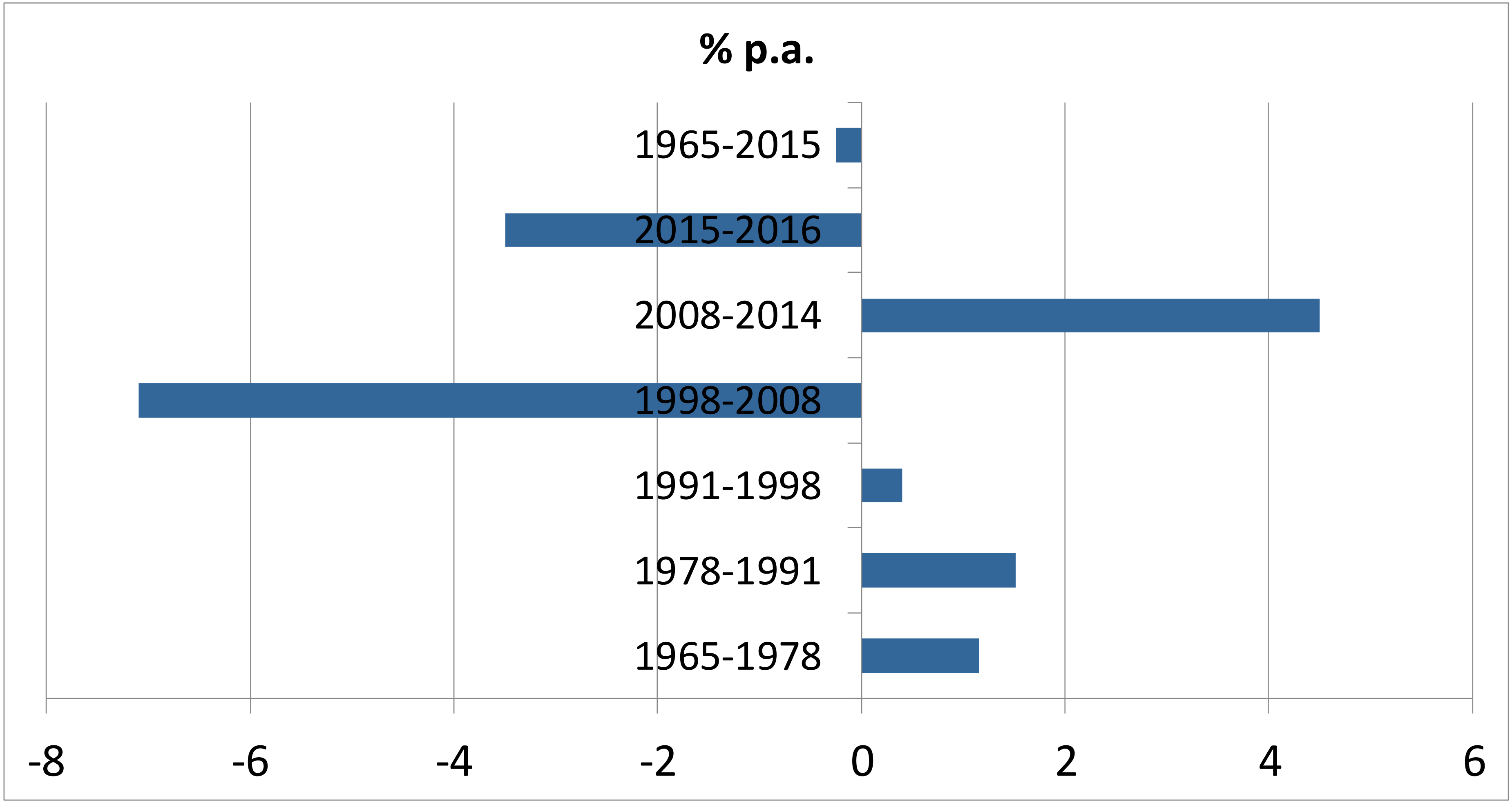
Income per head: Sub-Saharan Africa and Zimbabwe (1960-2015)



SLOWDOWN

- Dollarization sparked strong growth averaging over 9% until 2012.
- It has since slowed to a crawl – less than 1% a year.
- Per capita incomes have declined in 2015 and will likely fall further this year.

Income per head 1965-2016 (Constant US $ 2005)



Massaging the numbers

- As most in the room know, the claim of 1.5% GDP growth in 2015 is – to put it politely – fanciful, while the projected growth of 2.7% this year depends on much better rainfall than is being forecast as well as far cheaper electricity availability than seems probable.

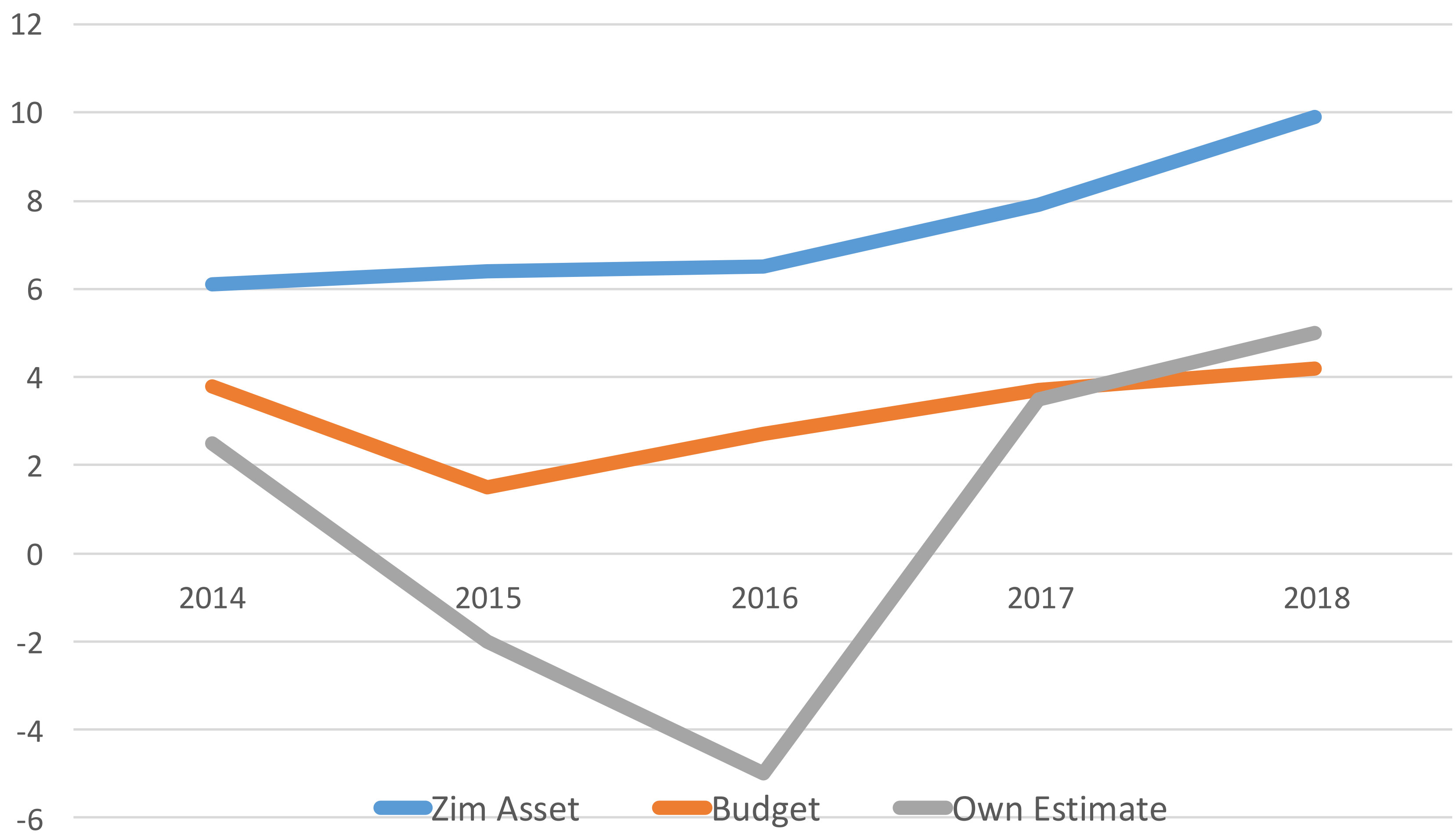
A BREATH OF REALISM

- In the greater scheme of things minimal growth of the kind claimed by the government matters little.
- More important is the yawning gap between the never-realistic Zim-Asset projections and those in last November 2015 Budget Strategy paper.

UNWILLING TO FACE FACTS

- Sadly, in the light of the preponderance of downside risks over the next few years, even the Budget paper’s greater realism than Zim-Asset and the public statements of Minister Chinamasa could turn out to be overly optimistic, as the slide suggests.

GROWTH ESTIMATES (% p.a.)



THE CONTEXT

GLOBAL ECONOMY

- Growth has slowed both globally and regionally and is forecast to remain below potential for the new few years.
- World trade growth will remain sluggish while few analysts anticipate a sustained uptick in commodity prices before 2017/18.

- Even then, the commodity price recovery will be modest.
- Not just because of China’s slowdown, but
- Also because of the changed and changing pattern of global demand, as evidenced in the current negotiations to reduce carbon emissions.

EXPORT-LED INDUSTRIALIZATION

- The Asian economic miracles of the late 20th and early 21st centuries were driven by industrialization.
- Invariably, growth was export-led and invariably also on the back of under-valued exchange rates.

EXPORT MODEL BROKEN

- That export-led model is now broken, though we continue to see countries resorting to currency manipulation to reboot their economies and specifically their industrial and mining sectors.
- This option is not available to Zimbabwe at present.

DE-INDUSTRIALIZATION

- It is not just the export-led growth model that is broken but the industrialization one as well.
- Many Emerging Markets, including most in SSA, are de-industrializing and with the recent slide in the mining and energy sectors, growth is being driven by services and the informal sector while agriculture stagnates.

UNEMPLOYMENT

- With the loss of manufacturing as a growth engine for employment (as was the case in Asia) there is a growing army of under-employed and unemployed youth, many of whom are well-educated.

RADICALIZATION

- These are fertile grounds for “radicalization”, often with religious or ethnic connotations.
- It is also a driver of populism of the kind that political parties have sought – unsuccessfully – to exploit through controversial policies.

IMPLICATIONS FOR ZIMBABWE

THE FIVE UNSUSTAINABLES

1. The exchange rate and balance of payments
2. External debt and a deteriorating domestic debt burden
3. The consumption-savings imbalance
4. The infrastructure deficit and
5. The budget

- I would be surprised if there was much disagreement with my 5 unsustainables, though some would rightly criticize my omission of the also unsustainable, deepening social crisis.
- There will however, be substantial disagreement at economic and political level over measures for resolving them.

CONVENTIONAL WISDOM

- The contemporary, conventional wisdom – wisdom is the wrong word – is that these problems can and will be resolved by a cocktail of measures, some of which will make matters worse rather than better.

SOLUTIONS

1. Apparently, the debt crisis will be solved by borrowing even more – from China and others for projects, from Algeria to pay arrears, from NSSA (or whoever) to take over Telecel and from (I don't know whom) to restructure Zisco, Cottco etc.

DEBT DISTRESS

- Earlier this year the IMF, whose numbers I should stress are unreliable, estimated Zimbabwe’s debt-GDP ratio in 2015, including private sector debt, at 107%.

- This is a substantial underestimate in respect of unrecorded loans from non-OECD sources, uncertainties surrounding private, parastatal and local authority debt, and the inability to calculate, with any degree of accuracy, the extent to which Diaspora remittances reflect offshore borrowings.

UNSUSTAINABLE BURDEN

- Whatever the precise number, it is common cause – outside government – that the debt burden is unsustainable, especially when rapidly growing domestic debt, including corporates and households, is factored in.

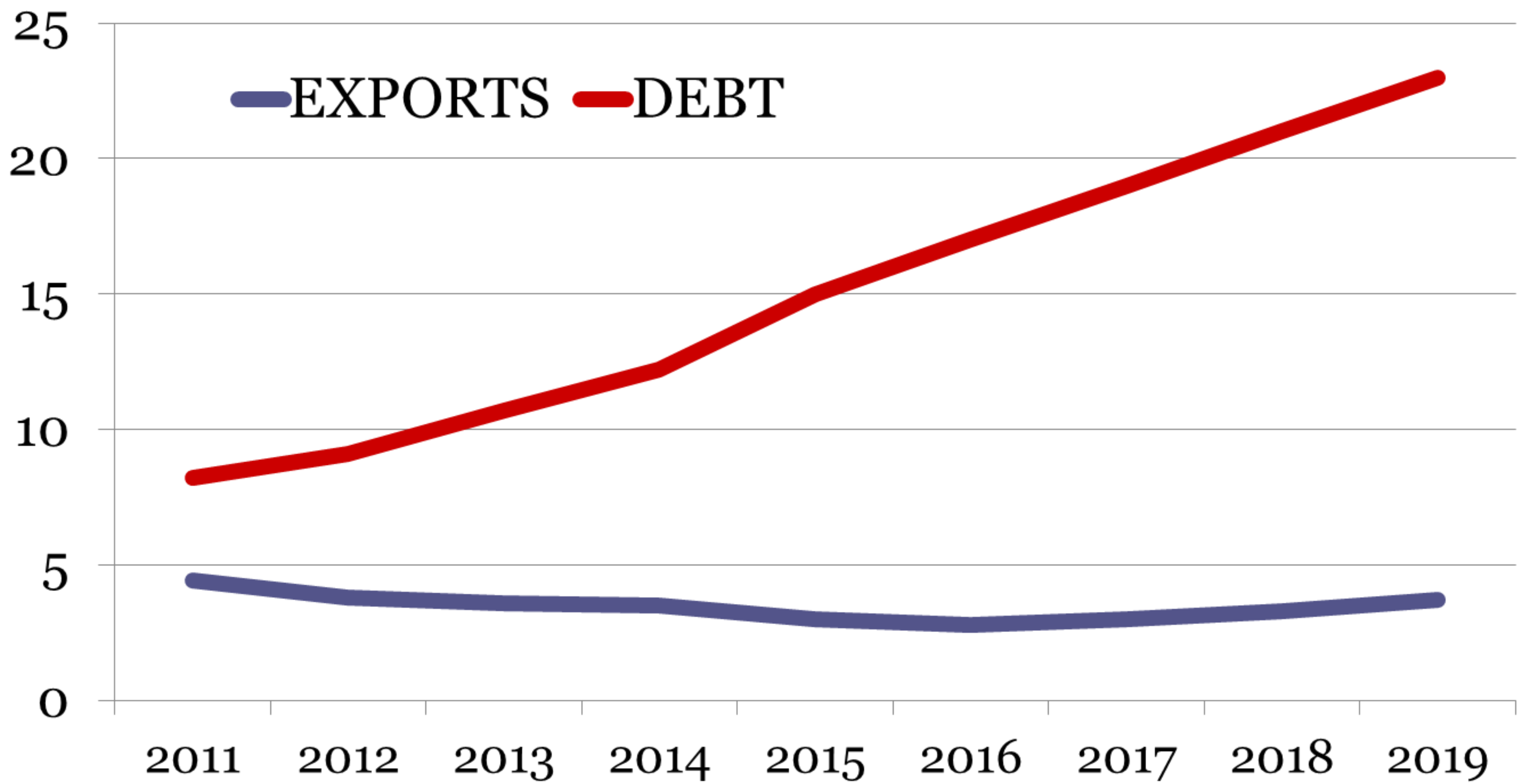
MORTGAGING THE FUTURE

- Servicing and repaying loans and contractor credits for infrastructure and industrial projects will absorb a large and growing chunk of future exports.

ARREARS CLEARANCE

2. Arrears clearance is part of the solution but – as in Zimbabwe's case where clearance takes the form of debt restructuring not debt reduction – total debt will continue to rise from 186% of exports in 2011 to over 600% (projected) by 2019.

DEBT VERSUS EXPORTS ($billions)



INTERNAL DEVALUATION

3. The mooted suggestions for tackling the balance-of-payments include “internal devaluation”, increased protectionism, export promotion and value addition to exports via beneficiation.

- All of these face formidable obstacles.
- Internal devaluation to the extent required (50%) is simply not feasible, either economically or politically, especially given existing levels of poverty and unemployment.

EXTERNAL, NOT INTERNAL

- For the record, leading EM economies, excluding China, have undergone real devaluation (on average) of some 40% since 2010.
- But this was NOT achieved by internal devaluation but by 50% currency devaluation.

- In any event, the political cycle – elections in 2½ years time – is against squeezing incomes, wages, government spending and employment, to secure internal devaluation, especially of a 40% to 50% magnitude.
- It is just not practical politics, even if it were practical economics, which it isn't.

- Internal devaluation is successful only if it increases productivity and enhances competitiveness.
- How will this be achieved in a burgeoning, technologically backward informal sector starved of finance and skills?

- Large informal sectors are correlated with low productivity and low levels of incomes.
- Informal firms forced to operate in a business-unfriendly environment with a severe infrastructure deficit are far more likely to import than export.

- Government’s formula for boosting productivity and competitiveness is to make it easier for inefficient firms to stay in business by protecting them from competing imports.
- In so doing it contravenes trade agreements with SADC, COMESA and the tripartite FTA to which it is a signatory.

- Government’s position on internal devaluation – as on so many things – is hopelessly ambiguous.
- It says it wants to reduce the costs of doing business. So what does it do?
- It increases fuel duties so that it can pay bonuses to civil servants.
- That makes sense doesn’t it?

- History – recent experience in the Eurozone – and common sense tell us that internal devaluation is very unlikely to reboot the Zimbabwe economy, especially given the existing socio-political climate.

OPTIONS?

- So long as the US dollar remains as strong as it now is – probably gets even stronger – growth in Zimbabwe will be stunted by:
- the indirect impact of a firm dollar on commodity prices, and
- by an overvalued exchange rate.

OPTIONS?

- It may be that Zimbabwe will be rescued by a large US dollar devaluation (unlikely in the near-medium term).
- If not, then – at some point – we will have to seek a new and different currency peg.

MISSION IMPOSSIBLE

- I am not advocating a return to the Zimdlr.
- Merely stating the unpalatable truth that mission impossible promises of internal/fiscal devaluation – contradicted by taxes and policies that make it more expensive to do business – are no answer to the problem of currency overvaluation.

INFORMAL ECONOMY TO THE RESCUE

- Government – and its advisers in the IMF and elsewhere – seem to believe that the socio-political dimension of unemployment, stagnation and poverty can be swept under the informal economy carpet.
- But this is an option that has passed its expiry date.

REBALANCING

SPEND LESS, SAVE MORE

- Time is against discussion of the remaining unsustainables, but because it is completely ignored by the policymakers, let me raise the urgent necessity of rebalancing consumption, savings and investment in the Zimbabwe economy.

BIG SPENDERS

- Since dollarization, consumption spending has averaged 112% of GDP and savings have been negative.
- Investment is only 16% – enough to sustain GDP growth of 3% to 4%.

CONSUMPTION-LED GROWTH

- 90% of the increase in domestic spending has been consumption spending, 56% of that by the private sector and 44% by government, whose current spending has more than trebled from $900 million in 2009 to over $3 billion 5 years later.

MASSIVE IMBALANCE

- This massive imbalance and negative savings (minus 9% of GDP) means that investment, and with it growth, are wholly reliant on foreign funding – FDI, Diaspora, aid, foreign borrowing etc.

- Policymakers seem to believe that such dependence on foreign capital can not only continue but increase as illustrated in the signing of mega-deals with China.
- Yet reliance on foreign funding is a stop-start strategy as many EMs, including Ghana, Mozambique and Zambia, are now finding to their cost.

DOMESTIC SAVINGS ARE BETTER

- Furthermore, the politicians seem oblivious to the evidence that countries that rely more on domestic than foreign capital have been more successful in sustaining growth over time.

COST OF CAPITAL WILL RISE

- Going forward it will become increasingly difficult to attract foreign capital as global interest rates rise, starting next week in the US, followed in short order no doubt by SA.

FDI PREFERRED

- FDI is far and away the preferred vehicle for foreign capital, but it is motivated by market size and growth, resource endowment and geography rather than policy, risk or incentives.
- Indeed incentives have a negative impact since investors wonder why they are being “paid” to invest?

LOCATION MOTIVES FOR FDI 2013

MOTIVE	Projects	Project %
Domestic market growth potential	840	45.4
Proximity to market or customers	611	33
Regulations/business climate	380	20.6
Skilled workforce availability	328	17.7
Infrastructure and logistics	158	8.5
Industrial cluster/critical mass	119	6.4
Attractiveness/quality of life	89	4.8
IPA or government support	75	4
Technology or innovation	57	3.1
Lower costs	47	2.5
Other motives	194	10.5

- Over the long term, policies can influence some of these factors, but in a country where we have created fewer than 3000 jobs annually for 35 years, time is not on our side.

FUTURE PROSPECTS

HOSTAGE TO FORTUNE

- At present Zimbabwe is hostage to developments over which it has no control – commodity price movements, the weather and deteriorating conditions in the global economy, especially the slowdown of China and many other EMs.

LOOKING FOR QUICK FIXES

- Given the headwinds the global economy will face over the next few years, there is no quick-fix solution on offer.
- Yet day-by-day the politicians, the media, the diplomats insist that there are quick fixes on offer such as more loans from China or clearing arrears.

- The truth is that in a modest-growth global economy the best we can hope for over the next 5 years is growth of about 4% annually – meaning that it will take 10 to 15 years regain the income levels of 1998 or 1974.

- That clearly is unacceptable, but the shift to a higher growth trajectory is dependent on a paradigm shift, of which there is no indication at present.

- There must be a shift from today's silo-style focus on agriculture, mining or industry, to a value-chain, value-addition model that transcends such sector boundaries.

NEW GROWTH MODELS

- In the 21^{st} century, reliance on natural resources, low-cost labour and export-led growth no longer constitute an efficient growth path.
- Growth is driven by innovation, technology and relevant skills (as distinct from traditional education).

STRUCTURAL CHANGE

- Growth arises either from in-firm, in-sector productivity growth or, from the transfer of resources from low-productivity activities (such as small-holder farming and the informal sector) to higher productivity mining, manufacturing and (some) services.

STRUCURAL REGRESSION

- Zimbabwe is headed in the reverse direction – structural regression in the form of de-industrialization and the shift from a modern formal economy to an increasingly low-technology, low productivity, informal one.

FATAL FLAWS

- I cannot think of a successful economy that has developed:
  - ❖Purely on foreign capital, AND
  - ❖With a hugely over-valued exchange rate.
- Yet both fatal flaws lie at the heart of today’s mooted growth path.

- Policymakers do not talk of re-balancing, do not focus on savings promotion, (indeed discourage it by cutting interest rates and using prescribed asset ratios at non-market rates to undermine savings).
- Nor is there any discussion of structural change – just a growth path driven by foreign capital.

CAPITAL OUTFLOWS

- Even here, ambiguity dominates.
- The authorities demand lower interest rates that will promote even greater consumption spending and, as rates rise globally, lead to BOP deterioration and capital outflows which the authorities will seek to curtail through a return to exchange controls.

CONCLUSION

SEARCHING FOR CONSENSUS

- In 2015, we can all agree that:
- The economy is not where we would like it to be and:
- That major policy changes are required.
- But we are not going to agree what those changes should be, how they should be implemented and by whom.

LIMITS TO POLICY

- We need to agree that in a small, open economy, with unsustainable levels of debt, unemployment, poverty, negative national savings and a daunting infrastructure deficit, that policymakers have very little room for manoeuvre – the more so in a difficult global business environment.

Headwinds & geopolitical risks

- The global environment is not conducive to a foreign-financed, export-led re-industrialization growth strategy.
  - ▶ Weaker prices for main exports
  - ▶ Monetary policy tightening – reduced and more expensive global financial flows
  - ▶ Greater risk aversion
  - ▶ A fast-changing global trade environment – reshoring (Mexico now cheaper manufacturer than China, etc.)

The past is a another world

- Paradigm shift does not mean forgetting the past, but learning from it.
- But development models that worked wonders in Asia and China in the 20th and early 21st centuries are no longer fit for purpose.

- In the 20th century structural change was a growth driver as workers and resources shifted from low-productivity farming, initially to industry and then to services.
- Today with the “servification” of industry that model no longer fits.

- Industrialization was seen as a seamless evolution from low-tech, labour intensive clothing, textiles, toys leather goods etc.,
- To medium-tech heavy industry and then to high-tech skills-intensive activities.

- Today, there are fewer and fewer opportunities in labour-intensive low-tech activities, while robots dominate in the medium-tech field such as vehicle manufacture.
- High-tech has supplanted labour intensity even in low-tech industries.

- Zimbabwe cannot follow the Asian/Chinese development models, which have been overtaken in a world where how you make and do things matters much more than what you do and make.

REAR-VIEW MIRROR ECONOMICS

- Unfortunately, the current policy debate in Zimbabwe – to the extent that there is one - seems rooted in the past.
- It is about promoting last decade’s or last century’s solutions and policies for tomorrow’s problems.
- That is unlikely to succeed.